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Supreme Court of the United States

OCTOBER TERM, 1965

No. 1084

JAMES P. MOZINGO, III, PETITIONER,

versus

YORK COUNTY NATURAL GAS AUTHORITY,
RESPONDENT

BRIEF OF RESPONDENT IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

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STATEMENT OF FACTS

The Statement in the Petition of the Petitioner seeking a Writ of Certiorari to the United States Court of Appeals for the Fourth Circuit is so sketchy that counsel for the Respondent are apprehensive that the issues here may not be readily comprehended.[1] Furthermore, certain state-

[1] Most of the proceedings are set forth as Appendices I, II, III, and IV to the Decree of the District Court (238 F. Supp., beginning at page 984).

ments in the Petition are at complete variance with the plan of composition approved by the District Court (238 F. Supp. 964) and affirmed by the Court of Appeals (352 F. (2d) 78).

Assertion is made in Petitioner's Statement, on page 3 of the Petition, that "the Court of Appeals approved portions of the plan which allowed some dissenting bondholders to be paid in cash for their bonds, while other dissenters, such as Petitioner, were denied any such option." Respondent asserts on the contrary that this statement is erroneous and constitutes a misinterpretation of the action of the Court of Appeals, for the reasons fully set forth in Question Number I under Respondent's Argument.

Amplifying Petitioner's Statement of Facts, Respondent points out that it is a public agency of the State of South Carolina. Committed to it was the function of constructing and operating a natural gas system to furnish natural gas service throughout York County, South Carolina. In order to raise the funds required for the construction of the system, it was authorized to issue revenue bonds payable solely from the revenues to be derived from the operation of its system. Pursuant to statutory authority duly given, it issued four series of bonds with serial maturities aggregating $3,778,000.00, whose proceeds were applied for that purpose.

These bonds were underwritten by a syndicate of investment bankers headed by White, Weld & Co. of New York. They were widely distributed throughout the eastern section of the United States and are now held by both institutional and private investors. Many are held in South Carolina.

From the outset the Authority encountered difficulties. Costs for construction were higher than expected and demand for gas was less than anticipated. Capitalized interest

was exhausted before earnings from operations were sufficient to meet the high interest cost at which Respondent had financed its construction. The original investment bankers faithfully kept abreast of the affairs of the Authority and rendered both advice and financial assistance.[2] Default nevertheless became inevitable.

After some improvement in earnings during several years of default in interest payments it was determined that if the rate of interest was reduced, the serial bonds converted to term bonds, and additional sums advanced for extensions to provide further customers, the Authority should be able to function in solvent condition. The refunding program and the Plan of Composition followed this determination and efforts to obtain required bondholders' consents were commenced early in 1964.

QUESTIONS PRESENTED

In order to simplify the Court's burden, we shall deal with questions presented in the Petition in the identical phraseology used by the Petitioner and in the chronological order appearing under Petitioner's heading "REASONS FOR GRANTING THE WRIT", which follows the numerical order of Petitioner's Questions.

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[2] On March 1, 1961, they advanced $95,758.00 to enable Respondent to meet certain coupons falling due on that date. 238 F. Supp. 969.

ARGUMENT

I. May a plan of composition under the provisions of 11 U. S. C. 403 (e) (1) be confirmed by a Federal Court as fair, equitable and non-discriminatory when the plan makes provision for payment in cash to some dissenting bondholder-creditors for their bonds, without providing for sufficient cash to make such payment to all dissenting bondholder-creditors of the same class, and without designating or disclosing which of said bondholders are to be preferred in making such payment?

The answer to the question as phrased by the Petitioner is obviously "No"; but the plan of composition presented to the District Court and approved by it and by the Court of Appeals contained no such inequitable provision and if it had it should not receive this Court's approval. All bondholders, assenting and dissenting, receive like treatment.

Under the plan submitted and approved, no dissenting bondholder is to be paid in cash. Each bondholder, assenting or dissenting, gets exactly the same security, *viz.*, bonds of Series A [3] for like face amount, plus Certificates of Indebtedness for unpaid interest to March 1, 1964. (See Appendix (a) and (b) .)

It is clearly apparent that both the District Court and the Court of Appeals made certain of this situation and required this result. Both courts have carefully prescribed a cut-off date and provided that if outstanding bonds not already deposited for direct exchange were not exchanged by that time, the obligations of the Authority with respect to such outstanding bonds would thereupon terminate.

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[3] While all bonds of Series A are term bonds, the Resolution provides for a mandatory call of the refunding bonds in chronological order out of surpluse earnings. The plan provides that in effecting the exchange, priority in numbering shall be observed among the outstanding bonds, so that those holding the earlier dated outstanding bonds shall receive lower numbered bonds than those who hold outstanding bonds of a later date.

Though the Court of Appeals made reference to use of a part of the proceeds of Series B Bonds by the investment bankers "to purchase outstanding bonds from persons unable or unwilling to exchange them for new ones", this single statement must be read in context to be interpreted fairly and to avoid a misleading and erroneous interpretation. It must also be read with due regard for all other provisions of the same Decree, and with every effort to properly reconcile any and all portions thereof. Here the Court was simply reciting background circumstances leading up to presentation of this matter to the District Court for consideration. As already noted, the Court of Appeals has without doubt negatived any such result by the cut-off date it properly prescribed.

It was recognized at the inception of planning for a refunding program that in certain instances, expected to be few in number, holders of Outstanding Bonds might be legally unable or unwilling to agree to the exchange. Initially the investment bankers were to be responsible for acquiring any such bonds through use of the proceeds of B Bonds on a Bond for Bond basis. However, it was soon recognized that any approach of this sort was capable of creating inequities which might require additional consent and approval of all other bondholders. Accordingly, this approach was abandoned and in its initial Petition for Approval of Plan of Composition (Appendix I to Order of District Court, 238 F. Supp. 984) the Respondent Authority sought, in paragraph 12 of the Petition and paragraph (g) of the prayer thereof, to have the Court provide for deposit with the Fiscal Agent of Refunding Bonds and Certificates of Indebtedness for all Outstanding Bonds not deposited, and for voiding of the Outstanding Bonds still undeposited on a prescribed date some two years later. The Court of Appeals extended this date by some five additional

years. Therefore, Petitioner's assertion that the Court of Appeals approved a discriminatory cash payment to some but not all dissenting Bondholders is entirely unwarranted and should be disregarded. In its actual disposition of this question the Court of Appeals said (Petitioner's Appendix B, p. 45):

> "Our only difference with the District Judge is upon the time allowed those bondholders who at the date of the entry of the order were unable or unwilling to accept the plan, or were unknown, to present their bonds for exchange. In default of such timely tender, the bonds would be declared as no longer obligations of the Authority. 11 U. S. C. 403 (f). The limitation was put at two years from the effective day of the final decree or until March 1, 1967 (an interest period) whichever was the later date. We think that without detriment to the execution of the plan the permissible time for presentation of the old bonds should be extended until March 1, 1972. To comply the Authority has only to escrow a corresponding number of new bonds and certificates, with the designated fiscal agent, for delivery as and when the old bonds are tendered for exchange."

The contention here raised that the plan as submitted to the District Court would permit dissenting bondholders to be paid in cash was not raised by the Petitioner either in the District Court or in the Court of Appeals. It is argued here for the first time and should be disregarded for this additional reason.

Respondent does not believe that there is any proper reason for concern on this point, but if this Court shall have the slightest doubt in the matter, it suggests that the Petition for Certiorari be conditionally dismissed with a proviso to the effect that no present bondholder receive one cent in cash and that all be required to accept Bonds of Series A and Certificates of Indebtedness pursuant to

the approved plan. Respondent further contends that Petitioner has failed to show any disregard of duty by the Court of Apeals requiring corrective supervision by this Court to sustain granting of the Writ.

II. May a plan of composition, under the provisions of 11 U. S. C. 403 (e) (5) be confirmed by a Federal Court where such plan fails to disclose an agreement for the payment of fees to certain bondholders for the filing of their acceptance of the plan, when other bondholders of the same class are not apprised of such payment and do not receive a like fee for the filing of their acceptance?

Under the Plan of Composition approved by Respondent Authority the investment bankers employed to handle the transaction were to be paid a fee of 2½% of each bond obtained by them for exchange. As modified by the District Court and affirmed by the Court of Appeals, this was reduced by some 40% to 1½%.

The many outstanding bonds had been handled by many investment bankers throughout the eastern section of the United States. It was recognized that these bankers would have to assist the investment bankers sponsoring the plan of composition, inasmuch as they would have to both study the plan and solicit acceptance thereof from their customers. It was recognized that they would incur expenses in this connection. Hence, it was provided that for every $1,000 bond which the investment bankers brought into the plan of composition they would receive a fee of ½ of 1% or $5.00 from the sponsoring investment bankers. No distinction was made between bonds which these investment bankers might own themselves and the bonds of their customers. This compensation was not to be paid by the Authority but by the investment bankers sponsoring the plan out of the fees payable to them, and the quantum of these

payments did not affect the basic compensation to be paid by the Authority to the investment bankers sponsoring the plan. This matter was disposed of by the Court of Appeals in the following language:

> "A further objection was directed to the allowance of a fee to the investment bankers who had agreed to undertake the execution of the plan. The compensation consisted of a percentage of the face of such bonds as the bankers procured for exchange. The special point was made that the commission was allowable on bonds owned by the bankers in their own right and surrendered for exchange. The Court carefully weighed this factor and became satisfied of the fairness of the arrangement. It is significant that in approving the plan the Court appreciably reduced the compensation as originally proposed in the plan. This decision could have included a consideration of the argument pressed by the objector."

We have pointed out that the $5 fee to be paid to other investment bankers who assist the investment bankers sponsoring the plan of composition merely diminishes the compensation of the sponsoring investment bankers and does not in any way alter the amount which the Authority is obligated to pay for this service. Of course, it is apparent that indirectly the money comes from the Authority, and, thus, in this way investment bankers who own bonds of the Authority are better off than individual bondholders who are not investment bankers, to the extent of $5 per bond. On the other hand, it is quite apparent that the $5 payment was not allowed in order to create a preference among creditors, but to establish a fair method of compensating the investment bankers for a totally different service, *viz.*, that of soliciting consents. Respondent believes that this aspect of the plan is fair and equitable.

Surely this is a *de minimis* situation, as to which the Court of Appeals did not feel concern. Certainly it should

not disturb the basic plan, nor further delay payments by the Authority to its unfortunate bondholders.[4]

The District Court carefully differentiated the instant case from that of *American Mutual Life Insurance Co. v. Avon Park,* 311 U. S. 138, 61 S. Ct. 157, 85 L. Ed. 91, 136 A. L. R. 14, relied upon by Petitioner, finding no comparable factual situation and no factual basis for Petitioner's claim of lack of good faith or failure of disclosure (Petitioner's Appendix A, p. 38). The Court of Appeals affirmed this factual finding. Petitioner has failed to establish the right to have that finding disturbed in this Court, or to have same presented to this Court for consideration under *Certiorari.* The finding is not at variance with prior decisions of this Court.

Further answering this question with a simple analogy, counsel often enjoy the privileges of a railroad pass in exchange for legal services rendered, but this is in no way discriminatory against fare paying passengers who have rendered no such service. In like manner, there is no discrimination against any bondholders by allowance of reasonable compensation to investment bankers for necessary services rendered in implementing the Plan of Composition.

Whether the fees paid to soliciting investment bankers generally for procurement for exchange of bonds held for themselves or for others are fair and reasonable and nondiscriminatory represents a pure question of fact determined by the District Court adversely to Petitioner and affirmed by the Court of Appeals.

Concurrent findings of fact by two Courts below will not ordinarily be disturbed by the Supreme Court, which does not ordinarily grant *certiorari* to the Circuit Court of

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[4] Interest on the refunding bonds accrues from March 1, 1964, and will be paid upon the final approval of the plan of composition. There is no practical means of paying undelivered and unsurrendered coupons.

Appeals to review evidence and to discuss specific facts. (*Workman v. New York,* 21 S. Ct. 212, 179 U. S. 522, 45 L. Ed. 314; *U. S. v. Johnston,* 45 S. Ct. 496, 268 U. S. 220, 69 L. Ed. 925, and 28 U. S. C. A. 1254, Note 58.)

III. May a Federal Court impair the obligation of a bond in confirming a plan of composition under the provisions of 11 U. S. C. 401, and following, by declaring that all bonds not tendered for exchange within a limited period of time shall be forfeited and become null and void and of no force and effect, notwithstanding that such bonds provide for their maturity beyond the time limited by the Court for the tender of such bonds for exchange?

In the proceedings in the District Court, the Authority sought and obtained a cut-off date fixed at:

> "two years following the effective and binding date of final decree of approval of the Plan of Composition pursuant to subparagraph f of Section 403, Title 11, U. S. Code, or until the March 1, 1967 regular interest payment date, whichever shall last occur." [5]

for the surrender of outstanding bonds of the Authority in exchange for refunding bonds of Series A and Certificates of Indebtedness. The Order of the District Court further provided that unless outstanding bonds were deposited and exchanged within this period, all liability of the Authority with respect thereto should be extinguished.

This aspect of the Plan of Composition approved by the District Court was modified by the Court of Appeals, which extended the date for the deposit of outstanding bonds until March 1, 1972.

The power of the District Court sitting in bankruptcy to prescribe a date for the filing of claims and the extinguishment of claims against a bankrupt is inherent under

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[5] 238 F. Supp. 983.

the general bankruptcy laws. The time here provided, March 1, 1972, is more than equitable, for surely a period which even now extends for some six years from this date is ample to permit all persons who hold bonds of the Authority to learn of the plan and to take advantage of the exchange which it offers. A far shorter length of time was allowed in the case of *San Augustine County v. Cameron County Water Improvement District,* 202 F. (2d) 932. Like ruling occurred in *Gladeview Drainage District, Palm Beach County, Florida v. Keys,* 258 F. (2d) 273, *Certiorari* denied 79 S. Ct. 579, 359 U. S. 906, 3 L. Ed. 571.

The argument here suggests a complete misapprehension by the Petitioner of the nature of bankruptcy procedures and their resultant effect upon the bankrupt's creditors. It is a *sine qua non* that every bankruptcy procedure must affect, oftentimes adversely, the rights of the bankrupt's creditors, for bankruptcy is an extraordinary procedure made necessary by the inability of the bankrupt debtor to perform in accordance with the tenor of his existing obligations. But every contract is made subject to the laws of bankruptcy and the power of the Congress to legislate on this subject is expressly conferred by the Constitution of the United States, which provides that Congress shall have the power to establish uniform laws on the subject of bankruptcy throughout the United States, and to make all laws which shall be necessary and proper for carrying into execution the powers so granted.

Respondent has not asked to be discharged from liability on $600,000.00 in bonds as asserted by Appellant. It seeks only what may be called clean up relief by way of discharge from remaining responsibility as to such limited number of bonds as may remain outstanding, after full and ample opportunity for completion of the refunding exchange during a period now fixed by the Court of Ap-

peals for termination on March 1, 1972, which allows ample time for compliance with the Order of the District Court requiring surrender of all Outstanding Bonds for refunding exchange. This provision seeks relief only after continued failure of bondholders to surrender their bonds for refunding exchange as directed by the District Court. This procedure is fully supported by law (11 U. S. C. A. 430(f) and Note 30(a) thereunder. See *Mason v. Merced, Irr. Dist.* C. C. A. 1948, 165 F. (2d) 634, *certiorari* denied, 68 S. Ct. 1528, 334 U. S. 858, 92 L. Ed. 1778, rehearing denied, 69 S. Ct. 15, 335 U. S. 837, 93 L. Ed. 389, wherein extinguishment of rights under bonds not surrendered in 45 days after Order of District Court so requiring became final was declared reasonable.)

Petitioner charges that Respondent's request for a cut-off date raises a question as to whether the plan is fair and equitable and whether Respondent has acted in good faith. (Petition page 6.) Again these are matters of fact already determined adversely to Petitioner by two Courts below. Nevertheless, Respondent points out that the inclusion of a cut-off provision authorized by the applicable federal statute can constitute no evidence of lack of good faith as suggested by Petitioner. Bonds adequate to refund and exchange all outstanding bonds will be deposited with the Fiscal Agent and left on deposit until the end of the prescribed cut-off date approved by the Court. What Respondent seeks by this provision is to be relieved of the necessity of leaving such refunding bonds with the Fiscal Agent forever, and continuing to provide interest payments for such bonds, after same are not exchanged for Outstanding Bonds within the time approved and allowed by the Court. This provision is entirely reasonable and imposes no undue hardship on any bondholder.

IV. May a Federal Court, in furtherance of a plan of composition, force the holders of first-mortgage bonds to surrender their bonds, and accept in exchange therefor, refunding bonds which allow the debtor to issue an unlimited number of "prior lien bonds" which constitute a claim superior to that of the refunding bonds?

Here again, as under Question III, is a matter of exercise of the powers of bankruptcy by a Federal Court having jurisdiction to administer the provisions of this federal statute. The Bankruptcy Act admittedly works an impairment of the obligation of contracts. This is particularly true as to those provisions discharging certain bankrupt debtors from their obligations in their entirety, but it is uniformly held that the provision of the Constitution of the United States proscribing states from passing laws impairing the obligation of contracts limits the states only but does not limit or impair the plenary power of the Congress to enact bankruptcy laws which do impair the obligation of contracts. This gives to the Court the right to alter the prior Bond Contract and to prescribe the terms of the new Bond Contract as it shall deem necessary and proper.

The 1964 South Carolina statute (No. 1373), set forth *in toto* in the Decree of the District Court (238 F. Supp. 969), specifically provides that the refunding bonds "shall have such claim to the revenues of the system as the Authority shall provide". The obvious wisdom of the provision permitting the issuance of prior lien bonds is apparent.

Both the outstanding bonds and the proposed refunding bonds are payable from revenues remaining after meeting the costs of operation and maintenance, including specifically the cost of purchasing gas. Without payment of operating costs there would be no operations and no revenues. Hence it is uniformly recognized in the issuance of

Revenue Bonds that the Bond Resolution must provide for payment of operational costs ahead of debt service costs. The provisions of the Refunding Bond Resolution for issuance of Prior Lien Bonds [6] requires that same may not be issued except under a Certificate of Consulting Engineer showing that operation of the system will be improved and that the unit cost of gas, following acquisition or construction of any transmission line to a new source of gas supply, will not be increased. This is designed to insure that operational costs shall not be increased in such manner as to reduce revenues remaining for debt service. In fact if operations are improved, it could well increase the revenue available for debt service.

The Plan of Composition necessarily took cognizance of the situation faced by the Authority in connection with its gas supply. The Authority is not a producer of natural gas, nor does it have access to the transmission lines of any interstate supplier. It was and is wholly dependent for gas upon an intrastate company,[7] which in turn buys gas from two major pipeline companies (Transcontinental and Southern Natural).

Without a sufficient supply of gas, the Authority is helpless, both to fulfill its function or to pay its creditors. The record establishes that the Respondent has a gas supply contract with its present supplier expiring in 1978. The refunding bonds are expressed to mature in the year 1994. Accordingly, the proceedings provide that if it became necessary to obtain a supply of gas, the Authority might issue prior lien bonds whose proceeds should be used to defray the cost of acquiring transmission lines in order to provide a source of supply for the system of the Authority.

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[6] See Appendix (c).

[7] The unusual interest of the Authority's supplier is discussed by the District Court at some length, beginning at the bottom of page 976, 238 F. Supp.

The Court of Appeals disposed of this same objection in the following language:

> "Special objection was lodged by the protestant to the provision in the plan allowing issuance of the prior lien bonds already described, because these bonds would have primacy over the new refunding bonds. Their authorization was one of the proposals included in the plan as it was submitted to the creditors in a memorandum prior to their approval of the plan. The principal reason for the provision for these bonds was to safeguard the Authority from the risk of entire and absolute dependence upon a single supplier of gas. Protection of the earlier bondholders against abuse by the Authority of this power is found in the requirement of the plan that the bonds could be issued only after actual notice to the registrar of the outstanding bonds, and general notice by publication to their holders, of the intention to float prior lien bonds. This stipulation implies the right of the bondholders to be heard and to show cause why such bonds should not be issued. We are unpersuaded that the District Judge erred in not rejecting the plan because of its provisions for prior lien bonds."

Again it is noted that the power of a bankruptcy court to modify existing contracts is obvious and apparent. Thus the question here is simply one of whether this aspect of the plan is fair and equitable. The finding of fairness by the District Court was in reality the resolution of a factual matter. Following its approval by the Court of Appeals, it should not be disturbed here after prior approval by two Courts below. Certainly nothing has been advanced in the argument of Petitioner which would indicate a need for or right to this result.

No novel point of law is involved. It has long been fully recognized by decisions of this Court that federal bankruptcy laws take precedence over state laws which would impair efficacy of the Bankruptcy Laws.

CONCLUSION

From the foregoing it is apparent that the Petition for Writ of *Certiorari* has no basic substance and should be denied. Rule 19 of the Rules of the Supreme Court specifically prescribes that a review on writ of *Certiorari* is not a matter of right, but of sound judicial discretion, and will be granted only where there are special and important reasons therefor. No reason of the character required by the Rule has been shown to exist in this case. The matters complained of appear to flow from improper and unwarranted interpretation of the findings and rulings below and from complaint as to basic factual determinations supported by action of two Courts below and not normally subject to further consideration by this Court. Respondent has vainly sought final authority during almost two years to resume interest payments to its bondholders under the approved Plan of Composition. It is right and proper and in the best interests of these bondholders, of the Respondent Authority and of the general public served by the Authority that *Certiorari* be forthwith denied to the end that the approved Plan of Composition may be implemented without further delay.

Respectfully submitted,

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Rock Hill, S. C.,
March 10, 1966.